Stocks Post a Nice Rebound as the War Wages in Ukraine

By Bob Deitrick, CEO
Tuesday, March 29th, 2022

The U.S. stock market came off its best two weeks since November of 2020, as the bulls returned sending the Nasdaq up 12%, the S&P 500 up ~ 8%, and the Dow Industrials up 7.5% in two weeks. This transpired as the Fed bumped interest rates up 25 basis points and flagged potentially 4 to 7 more rate hikes through the balance of this year. The Fed would like to see the overnight lending rate at 2.4% by the end of 2022. The Fed predicts inflation will cool down by midyear and fall sharply lower in 2023.[1] We agree with this notion. A burst of interest rate hikes will likely work but time will tell.

But what else brings down ridiculously high prices? Higher prices.

Consumers get fatigue and pullback when prices stay too high for too long. We saw indications of that last week when February retail sales came in lower than expected at a 0.3% increase from January.[2] The Fed also lowered its forecast for U.S. GDP for the year from 4% to 2.8%.[3] The bond market is whistling warning signs as the yield curve flattens, something Steven has talked about in our seminars on numerous occasions. Essentially yields on long-term bonds, which are typically higher than short-term bonds, are falling as investors pile money back into them looking for safety. Yields fall as prices rise and as those yields fall, they're approaching the yield on short-term government bonds which have been rising as investors sense a bleaker economic outlook. A flattening yield curve is concerning, but an inverted yield curve is very problematic when the yield on long-term bonds falls below those of short-term bonds signifying recession. We're not there, but Steven and I are paying very close attention to the bond market daily for you.

We are surrounded by walls of worry. But this market has shown great resilience, time and again. As we have stated on numerous occasions:

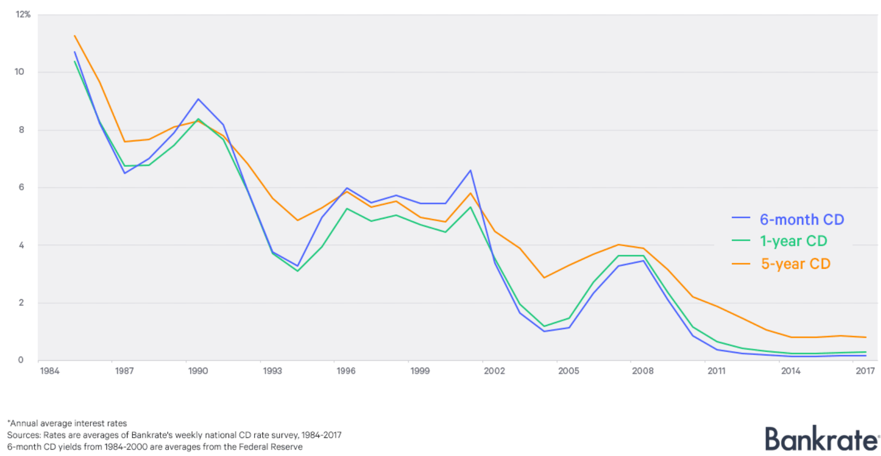
Strong markets climb walls of worry.

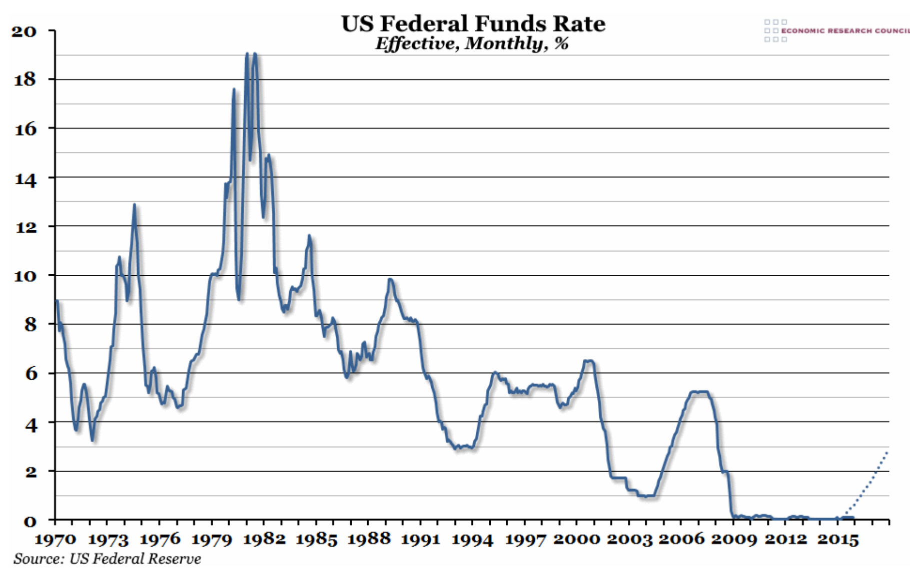
We're worried about inflation, the war in the Ukraine, rising interest rates, and we're worried about things we don't even know about. There is plenty to worry about today indeed. This is what the uncertainty of war creates. However, a good thing to do when the walls of worry are closing in on you is to generate perspective - to look back at where we've been, how things have played out in the past and to look for clues about what might be in store for our future:

- ***First, this is a midterm year. Historically we see a 17% peak-to-trough correction in mid-term cycles, the most volatile out of the four year cycle in mid-terms.[4] We have seen that already this year. We could see another correction this year, but the worst is over we suspect.***
- ***We know this economic cycle is maturing, having started in 2009. We knew the Fed was going to start hiking rates. The Fed did this in early 2016, when they started hiking rates, and that wasn't the best time for the market until the market found its footing. The market will likely find its footing this time as well.***

- ***Keep in mind - during the bull market of the 1980's from September of 1982 until October of 1987, the market had a huge run up when interest rates were much higher and CD rates were paying 7% to 10%! The Fed funds rate ranged from 6% to 12% relative to what it is today, and we had a great run-in stock in the 1980's. I remember these days and the bull market run of the Reagan years in the beginning of my career (and when Steven was born in 1985) fondly.***

Historical CD average rates*: 1984–2017





- ***Are rate hikes kryptonite to stocks? Absolutely not. Historically, I looked at the last seven times the Fed did the first-rate hike in a new bull cycle and one year later the S&P was higher.*** [5] ***In fact, after that first rate hike the stock market did not peak until three and a half years later - on average.***

- ***Let's review the concerns out there. Is the Fed behind the curve? Are they going to hike rates too fast? What about all the geopolitical concerns and the war in Ukraine. What's going to happen with China and Taiwan? Steven and I get paid to worry for you as the stewards of*** *your assets, and these concerns are valid, and we understand and empathize with your concern.*

- *In the 14 months following the Cuban Missile Crisis - from October of 1962 through 1963, US stocks appreciated more than 25%.*[6]
- *Let's look at 2022 so far. We had our 50th trading day for the year last week. This is the sixth-worst start to a year for the S&P 500 in its all-time history. But when you look at the other five worst times, the rest of the year was higher, not lower…*[7] *We believe 5000 to 5200 on the S&P 500 is still realistic by the close of this year. That is a modest year considering the last three years but anything in the black this year is a good result. We closed at 4631 today having been at 4176 just two weeks ago...*
- *Bank of America's recent Global Fund Manager Survey shows that sentiment is bearish. Cash levels, economic projections, and profit expectations are recessionary, but their equity allocations are not. While fund managers fear the worst, they're not scared enough to capitulate and get out of their stock positions and that may or will keep support under the market if it tumbles again.*[3]
- *If the ten-year yield tops out at 2.25% to 2.5% that means that TINA (There is No Alternative) comes back and favors the tech sector for a variety of reasons. We also continue to believe that the United States is the best place to be invested for wealthy investors in the US, Asia, and Europe. That translates into more money pouring in the U.S. hypothetically as well.*
- *Stocks are going through a very difficult period today because the bond market is hawkish, and the Fed is going to raise rates this year. Consumers are taking a hit at the Wendy's and Chick fil-A drive through and at the gas pump and we get that. However, if we avoid recession, and we believe today that we will, things will be fine. Consumer confidence is higher than it was in 2009 and consumers have a lot more cash today as well. People are pricing in a calamitous situation, and we believe that is when stocks may or are likely to begin a rally.*

The truth is we will not know what is going to happen for a few more months until after the war in Ukraine has subsided and until we see if inflation remains into check or not and if the consumer remains intact. *Consumer savings are in great shape after COVID and all of the money having been doled out by the government over the past two years and consumer debt levels are really low so we may NOT see a contraction so we think there is the possibility that we will see a positive surprise out of the consumer especially as it relates to the pent up demand to get out and see the world and to travel and to see family et al post-COVID. And surprisingly war times have historically been good for the economy so we may see a surprise in the second half of this year. Time will tell. So given how great anticipation is that things could get worse, we think things may get better, on some economic fronts at least.*

We believe that the sectors to favor this year are basic materials, FAANG, some financials, cyclicals, leisure, and upscale travel. We will be making changes to portfolios this month to take advantage of the opportunities we see in the current market. As always, to the extent you have any questions, do not hesitate to contact us at any time. Have a terrific week as we welcome the Spring weather.

Our next academic seminar will be held on June 11th at Eddie Merlot's over a Saturday brunch.

[1] *https://www.bloomberg.com/news/articles/2022-03-16/fed-lifts-rates-a-quarter-point-in-opening-bid-to-curb-inflation*

[2] https://www.reuters.com/business/retail-consumer/us-retail-sales-increase-moderately-february-2022-03-16/

[3] https://www.bloomberg.com/news/articles/2022-03-15/fund-managers-now-see-equity-bear-market-in-2008-like-gloom

[4]*https://www.investopedia.com/the-express-podcast-episode-78-5222994*

5https://www.investopedia.com/the-express-podcast-episode-78-5222994

[6]*https://advisor.visualcapitalist.com/historical-stock-market-returns/*

7https://www.investopedia.com/the-express-podcast-episode-78-5222994